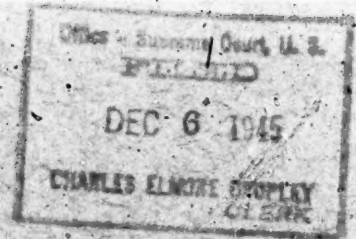


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No. 93

In the Supreme Court of the United States

OCTOBER TERM, 1945

HERCULES GASOLINE COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE FIFTH CIRCUIT**

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 69-72) is unreported; the majority and dissenting opinions of the Circuit Court of Appeals (R. 81-86) ~~is~~ reported at 147 F. 2d 972.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 1, 1945 (R. 86). The petition for rehearing was denied on April 19, 1945 (R. 89). The petition for a writ of certiorari was filed on May 28, 1945, and granted on October 8, 1945 (R. 91). The jurisdiction of

this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether credit against undistributed profits tax is allowable under Section 26 (c) (1) of the Revenue Act of 1936 where the claim rests upon a provision of the taxpayer's stock certificates incorporating by reference a term of its charter.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations will be found in the Appendix, *infra*, pp. 37-42.

STATEMENT

The pertinent facts, taken from the findings of the Tax Court (R. 64-69), are as follows:

The petitioner is a Delaware corporation organized in 1939 and domiciled in Wilmington. It admits liability as transferee of the assets of Hercules Gasoline Company, Inc. (hereinafter called the transferor), a Louisiana corporation, which was dissolved in 1939. (R. 65.)

The original charter of the transferor duly filed and recorded in the state of its domicile in 1933 contained the following provision (R. 65-66):

ARTICLE V

The Capital stock of this corporation is hereby fixed at 8,000 shares of no par value common stock and 400 shares of \$50.00 par

value of preferred stock, which said stock shall be paid for in cash at the time of issuance or for service rendered or property actually received and shall be full-paid and nonassessable.

The following rights, privileges and conditions shall attach to the shares aforesaid, viz:

(a) The preferred stock shall be entitled, out of any and all surplus net profits whenever declared by the Board of Directors, to cumulative dividends at the rate of 8% per annum for each and every year from the issuance of such stock, payable semi-annually, in preference and priority to any payment of any dividend on the common stock for such year.

* * * * *

(c) The common stock shall be subject to the prior rights of the holders of the preferred stock as above declared and there shall be no dividend on the common stock until all of the preferred stock has been retired, redeemed and discharged.

* * * * *

At a meeting of the stockholders of the transferor held in 1935, a resolution was adopted to amend the charter in order to increase the authorized number of shares of preferred stock from 400 to 1,400, which amendment was duly filed and recorded. The amendment as contained in the resolution and as made to the charter was in the same language as that contained in Article

V of the original charter except that the number of shares of preferred stock was shown as 1,400 instead of 400. (R. 66-67.)

All certificates of preferred stock, whether issued before or after the amendment to the charter, contained the following provision (R. 67):

For Rights and Voting Powers of Preferred Stock See Article V of Charter.

During 1937 and 1938 the transferor had outstanding 1,294 shares of preferred stock of a total par value of \$64,700, all of which had been issued prior to May 1, 1936 [the critical statutory date], and all of which were retired in 1939 (R. 67).

In assessing the deficiency for 1937, the Commissioner determined that the provision in the transferor's charter, incorporated by reference into its preferred stock certificates, which provision prohibited the payment of dividends on common stock so long as any of the preferred stock was outstanding, did not constitute a contract prohibiting the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936 (R. 68). The Commissioner was sustained in the Tax Court, and the Circuit Court of Appeals, with one judge dissenting (R. 84-86), affirmed (R. 81-84).

SUMMARY OF ARGUMENT

I

The Revenue Act of 1936 levied a surtax on the undistributed net income of corporations, but pro-

vided for a credit based upon the portion of the corporate earnings which could not be distributed—

without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. (Sec. 26 (c) (1).)

The petitioner considers that its transferor was entitled to this statutory credit for the year 1937, the claim being predicated upon Article V of the transferor's charter and upon the provision of its preferred stock certificates which incorporated that article by reference. The pertinent charter term provided in part:

(c) The common stock shall be subject to the prior rights of the holders of the preferred stock as above declared and there shall be no dividend on the common stock until all of the preferred stock has been retired, redeemed and discharged.

During the taxable year, the transferor corporation had outstanding 1,294 shares of preferred stock, which stock was not fully retired until 1939.

The Government maintains that the Tax Court correctly sustained the Commissioner's disallowance of credit under Section 26 (c) (1) in computing the transferor corporation's undistributed profits tax for 1937, and that the majority of the

court below properly held such denial to be necessitated by this Court's opinion in the case of *Helvering v. Northwest Steel Mills*, 311 U. S. 46. Neither the transferor's stock certificates nor its corporate charter fulfilled the conditions to credit prescribed by Section 26 (c) (1). That Section, we think, is confined to contracts made with creditors and does not extend to restrictions imposed within the body corporate such as those now at bar. Moreover, the certificates in question did not "expressly" prohibit the payment of dividends within the meaning of the statute, nor was the transferor's charter an instrument "executed" by it as Section 26 (c) (1) requires.

The Circuit Courts of Appeals for the First and Sixth Circuits, and now for the Fifth, are in accord with the Government's position that the credit grant of Section 26 (c) (1) is limited to creditor contracts; the Third Circuit stands alone among the Circuit Courts of Appeals in holding that intracorporate agreements are "contracts" within the purview of Section 26 (c) (1). The Tax Court has always held the view that credit cannot be grounded on charter provisions; and it has also from the outset been the understanding of the Treasury that charter-imposed restrictions do not constitute a qualifying basis for credit under Section 26 (c) (1). Since rendition of the *Northwest Steel* decision the Tax Court and Treas-

7
ury have taken that view with respect to restrictions contained in stock certificates as well.

The legislative history illustrates that Section 26 (c) (1) was intended to be confined to routine contracts dealing with ordinary debts. Congress was interested in alleviating the hardship which the surtax imposed on corporations which found themselves contractually obligated to retain their earnings. If the restraint was imposed at the behest of creditors, there was little likelihood of its removal. If, however, the inability to pay dividends arose from commitments previously made to members of the body corporate, the corporation was in a better position to extricate itself from the surtax burden; an owner likely would, in the interests of the corporation, waive rights which a creditor would not.

Reference to the second paragraph of Section 26 (c) substantiates the view that Congress intended creditor obligations alone to afford foundation for credit under the first paragraph. Section 26 (c) (2) allowed credit in respect of earnings which a corporation was contractually obligated to pay or irrevocably to set aside for the discharge of debts. In Section 26 (c) (2) Congress expressly specified the nature of the obligation, and undoubtedly expected the two paragraphs to be read as *in pari materia*.

II

Assuming that internally imposed restrictions are within the grace of the statute, the petitioner has still not made a case for preferential treatment. Section 26 (c) (1), as we have noted, provides specifically that the contract upon which reliance is placed shall be "executed" by the corporation. The petitioner must necessarily depend upon its transferor's charter, since there is no prohibitory provision in the certificates unless the pertinent charter term be read into them. A corporate charter is not a contract "executed" by the corporation, for the ordinary meaning of the word "executed", when used with reference to a written instrument, is "signed", or "signed, sealed, and delivered".

Section 26 (c) (1) also provides specifically that the contract relied upon must "expressly" deal with the payment of dividends. The necessity in the case at bar of referring to the charter in order to find any prohibition upon dividend payments in the stock certificates prevents considering those certificates as contracts "expressly" dealing with the payment of dividends.

ARGUMENT

Introductory.—This case presents the question of the proper construction of a portion of the undistributed profits tax law enacted by Congress as part of the Revenue Act of 1936, which imposed a surtax at graduated rates upon such of the

profits of corporations as were not distributed during the tax year by way of dividends. Revenue Act of 1936, Section 14, Appendix, *infra*, pp. 37-38. The major purposes of this levy, which was abandoned in the Revenue Act of 1938, were to equalize the tax burden on all corporate incomes whether distributed or not, and to prevent the avoidance of surtax by individual stockholders through the impounding of corporate profits in surplus. See H. Rep. No. 2475, 74th Cong., 2d Sess., pp. 1-3 (1939-1 Cum. Bull. (Part 2) 667). The basis of the tax, as formulated in Section 14, was that portion of the "undistributed net income" of the corporation which was in excess of specified percentages of the "adjusted net income". Section 14 (a) defined "adjusted net income" as income less specified credits, and "undistributed net income" was declared to be the adjusted net income less the amount of the dividends paid during the tax year and less the credits provided in Section 26 (c), Appendix, *infra*, pp. 38-39. The latter Section was designed to afford relief from the surtax, in certain narrowly circumscribed situations, to corporations which were contractually prevented from distributing their profits. The measure provided in pertinent part:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(c) *Contracts Restricting Payment of Dividends.*—

(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. * * *

(2) *Disposition of profits of taxable year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. * * *

It will be observed that paragraph (1) deals with negative restrictions preventing the distribution of earnings, and paragraph (2) deals with affirmative covenants by which earnings are irrevocably committed to the payment of debts. A more fundamental distinction between the two paragraphs is the manner in which the credit is computed, normally resulting in greater preference

where the corporation is obliged actually to pay out or irrevocably to set aside its earnings than where it is only negatively committed not to distribute them to its shareholders.¹

The case at bar is specifically concerned with the proper interpretation and application of paragraph (1) of the foregoing Section. During 1937, the taxable year, petitioner's transferor corporation had outstanding 1,294 shares of preferred stock of a total par value of \$64,700, all of which had been issued prior to May 1, 1936 (R. 67). Every preferred stock certificate carried the legend (R. 67)—

For Rights and Voting Powers of Preferred Stock See Article V of Charter.

The pertinent part of Article V of the transferor's charter, to which this reference was made, read as follows (R. 65-66)—

The Capital stock of this corporation is hereby fixed at 8,000 shares of no par value

Under paragraph (2) the credit is equal to the amount of current earnings actually paid or set aside for the benefit of creditors. Under paragraph (1) account is taken of the earnings available for distribution, including accumulated earnings of prior years; and the credit is equal to the difference between this sum and the adjusted net income of the corporation. Thus a corporation subject merely to a negative restriction as to dividends payable out of current earnings may nevertheless be entitled to little or no credit under paragraph (1) if it has accumulated earnings of past years. See Regulations 94, Art. 26-2, Appendix, *infra*, pp. 39-42. Therefore the need for separate provisions was occasioned by the difference in the relief granted, rather than by a purpose to deal with fundamentally different corporate contracts.

common stock and 400 shares of \$50.00 par value of preferred stock,² which said stock shall be paid for in cash at the time of issuance or for service rendered or property actually received and shall be full-paid and nonassessable.

The following rights, privileges and conditions shall attach to the shares aforesaid, viz:

* * * * *

(c) *The common stock shall be subject to the prior rights of the holders of the preferred stock as above declared and there shall be no dividend on the common stock until all the preferred stock has been retired, redeemed and discharged. [Italics supplied.]*

* * * * *

The petitioner's derivative claim to credit under Section 26 (c) (1) rests upon the italicized language, *supra*. It is petitioner's thesis that inasmuch as the transferor's preferred stock was not fully retired until 1939 (R. 67), no dividend could have been paid during the taxable year upon the transferor's common without doing violence to this charter term which, incorporated by reference into the preferred share certificates, was allegedly:

a provision of a written contract executed by the corporation * * * which pro-

² Article V was amended in 1935 to increase the authorized number of preferred shares from 400 to 1,400 (R. 66).

vision expressly deals with the payment of dividends. (Sec. 26 (c) (1).)

It is the Government's position, however, that neither stock certificates nor corporate charter fulfilled the conditions to credit prescribed by Section 26 (c) (1). We maintain in the first place that neither instrument evidenced the kind of "contract" intended by the Section to form the basis for the statutory credit; they dealt with intracorporate rights, whereas the statute is limited to agreements with creditors. In the second place, we submit that the stock certificates did not "expressly" deal with the payment of dividends as the statute requires for they only incorporated the pivotal term of the corporate charter by reference, and the charter itself was not "executed" by the corporation as prescribed by Section 26 (c) (1).

The statute at issue grants in effect an exemption from tax, and accordingly the familiar principle that exemption statutes are to be strictly construed is applicable. *Helvering v. Butterworth*, 290 U. S. 365; *Willcuts v. Bunn*, 282 U. S. 216; *Hughes Tool Co. v. Commissioner*, 147 F. 2d 967 (C. C. A. 5th); *Keystone Mut. Casualty Co. v. Driscoll*, 137 F. 2d 907 (C. C. A. 3d). Section 26 (c) has from inception been the subject of particularly strict construction in this Court, in all of the Circuit Courts of Appeals and in

the Tax Court.³ Furthermore, a taxpayer who claims the privilege of preferred treatment by way of exemption has the burden of proving that his case plainly meets the spirit and the letter of the law. Cf. *White v. United States*, 305 U. S. 281; *New Colonial Co. v. Helvering*, 292 U. S. 435; *Helvering v. Magnus Beck Brewing Co.*, 132 F. 2d 379 (C. C. A. 2d).

In the Tax Court, denial of credit was principally based on that tribunal's view, held almost without deviation, that corporate charter and stock certificate provisions are not "contracts"

³ *Helvering v. Ohio Leather Co.*, 317 U. S. 102; *Helvering v. Northwest Steel Mills*, 311 U. S. 46. Representative examples of Circuit Courts of Appeals and Tax Court "strict construction" decisions are: *Elliott Addressing Mach. Co. v. Commissioner*, 131 F. 2d 700 (C. C. A. 1st); *Buffalo Slag Co. v. Commissioner*, 131 F. 2d 625 (C. C. A. 2d); *Welsbach Eng. & Management Corp. v. Commissioner*, 140 F. 2d 584 (C. C. A. 3d), certiorari denied, 322 U. S. 751; *Antietam Hotel Corp. v. Commissioner*, 123 F. 274 (C. C. A. 4th); *Commissioner v. Dulup Oil Co.*, 126 F. 2d 1019 (C. C. A. 5th); *Warren Tel. Co. v. Commissioner*, 128 F. 2d 503 (C. C. A. 6th), certiorari denied, 317 U. S. 697; *Commissioner v. E. C. Atkins & Co.*, 127 F. 2d 783 (C. C. A. 7th); *Helvering v. Moloney Electric Co.*, 120 F. 2d 617 (C. C. A. 8th), certiorari denied, 314 U. S. 682; *Guanacevi Mining Co. v. Commissioner*, 127 F. 2d 49 (C. C. A. 9th); *Atlas Supply Co. v. Commissioner*, 123 F. 2d 356 (C. C. A. 10th); *Staley Manufacturing Co. v. Commissioner*, 46 B. T. A. 199; *Eaton Paper Corp. v. Commissioner*, 1 T. C. 1; *Dr. Pepper Bottling Co. v. Commissioner*, 45 B. T. A. 540; *Campbell Transportation Co. v. Commissioner*, 43 B. T. A. 417.

within the purview of Section 26 (c) (1).⁴ That view was also the primary basis for the decision of the Circuit Court of Appeals herein (R. 83-84), and the point to which the dissenting member of the court voiced exception (R. 85-86).⁵ And since it is upon that point that the opinion of the Circuit Court of Appeals for the Third Circuit⁶ differs from that expressed by the majority below and by other Circuit Courts of Appeals which have passed on the question,⁷ we propose in Part I to substantiate our position that neither stock certificates nor corporate charters evidence the kind of contract upon which a claim to the statutory credit may properly be founded. For the purpose of that discussion, we shall assume that, within the meaning of Section 26 (c) (1), the transferor's charter was "exe-

⁴ Dicta to the contrary in respect of stock certificates, which appeared in *Airtherm Mfg. Co. v. Commissioner*, 43 B. T. A. 736, were expressly repudiated in the case of *Bishop & Babcock Manufacturing Co. v. Commissioner*, 45 B. T. A. 776, affirmed, 131 F. 2d 222 (C. C. A. 6th), remanded to the Tax Court on another issue, 133 F. 2d 199.

⁵ Both majority and minority appear to have understood (R. 83, 85) that petitioner was relying solely upon its transferor's stock certificates which incorporated the pertinent charter provision only by reference.

⁶ The Court of Claims is in accord with the Third Circuit. *Re: Hanover Mills Co. v. United States*, 53 F. Supp. 235.

⁷ *Lehigh Structural S. Co. v. Commissioner*, 127 F. 2d 67 (C. C. A. 3d); cf. *Warren Tel. Co. v. Commissioner*, 198 F. 2d 503 (C. C. A. 6th), certiorari denied, 317 U. S. 697; *Elliott Addressing Mach. Co. v. Commissioner*, 131 F. 2d 700 (C. C. A. 1st).

cuted" by the corporation and that its stock certificates "expressly" dealt with the payment of dividends. Demonstration of the fallacy of these assumptions will follow in Part II.

I

THE STATUTE CONTEMPLATES CONTRACTS WITH CREDITORS AND NOT RESTRICTIONS IMPOSED WITHIN THE FRAME- WORK OF THE CORPORATION ITSELF

In 1940, this Court passed in companion cases upon the claims to credit under Section 26 (c) (1) (Appendix, *infra*, p. 38) of two corporations whose domiciliary laws forbade dividend distributions during the existence of a corporate deficit. *Helvering v. Northwest Steel Mills*, 311 U. S. 46; *Crane-Johnson Co. v. Helvering*, 311 U. S. 54. The claimants were deficit corporations, and they argued, *inter alia*, that the prohibitory state law was an implied-in-law provision of their corporate charters, which were "contracts" within the meaning of the federal statute. The Court, rejecting both claims, declared in the *Northwest Steel* case (pp. 48, 50-51)—

The only "written contract executed by the corporation" upon which respondent relies for its claimed exemption is its corporate charter, granted by the State of Washington. * * *

It is true * * * that a charter has been judicially considered to be a contract insofar as it grants rights, properties,

privileges, and franchises. * * * But it does not follow that Congress intended to include corporate charters and related state laws in the cautiously limited area permissible for tax credits and deductions under this section. * * *

Mr. Justice Black, who spoke for the Court in *Northwest Steel* case, drew attention to the fact that the second paragraph of that Section (Appendix, *infra*, p. 38) expressly conditions credit upon the existence of an obligation to set earnings aside for the payment of corporate debts. He then stated (p. 50)—

That this section [Section 26 (c) (2)] referred to routine contracts dealing with ordinary debts * * * is obvious—yet the words used to indicate that the section had reference only to a “written contract executed by the corporation” are identical with those used in Section 26 (c) (1). There is no reason to believe that Congress intended that a broader meaning be attached to these words as used in Section 26 (c) (1) than attached to them under the necessary limitations of 26 (c) (2).

Thus, as to the kind of contract embraced and the formalities required, this Court has stated that there is complete identity between the two paragraphs of the statute. Each paragraph deals with, and is confined to, routine contracts dealing with ordinary debts which have been executed in writing by the claimant corporation. And as we have pointed out above, it is the difference in the

tax through the difference in the credit computation which essentially differentiates paragraphs (1) and (2) of Section 26 (c).

The Circuit Courts of Appeals for the Sixth and First Circuits and now for the Fifth, as witness this case, have taken the *Northwest Steel* decision to mean precisely what it says—that Section 26 (c) is limited in both paragraphs to routine contracts dealing with ordinary debts. *Warren Tel. Co. v. Commissioner*, 128 F. 2d 503 (C. C. A. 6th), certiorari denied, 317 U. S. 697; *Metal Specialty Co. v. Commissioner*, 128 F. 2d 259 (C. C. A. 6th); *Bishop & Babcock Manufacturing Co. v. Commissioner*, 131 F. 2d 222 (C. C. A. 6th), remanded to the Tax Court on another issue, 133 F. 2d 199; *Elliott Addressing Mach. Co. v. Commissioner*, 131 F. 2d 700 (C. C. A. 1st). The Circuit Court of Appeals for the Third Circuit stands alone among the Circuit Courts of Appeals in holding that the *Northwest Steel* case does not bar intra-corporate agreements as “contracts” within the purview of Section 26 (c) (1). That court early determined that stock certificates, which reiterated a charter provision setting up a sinking fund for retirement of the corporation’s preferred shares and expressly prohibiting dividends to other classes until the preferred had been discharged, was a “contract” provision under the statute. *Lehigh Structural S. Co. v. Commissioner*, 127 F. 2d 67. The court read (pp. 68–69) the *Northwest Steel* decision as meaning only that restrictive provisions imposed by state law and contained in charter and

stock certificates merely by implication are not sufficient under the statute; and the *Lehigh* case has several times been applied in the Third Circuit¹ to overrule Tax Court decisions which have expressed the view of that body that the *Northwest Steel* case has the broader connotations which the Sixth, First, and Fifth Circuits have given it.

The *Lehigh* case was decided prior to the time when the Circuit Court of Appeals for the Sixth Circuit was called upon to consider the question whether a taxpayer was entitled to Section 26 (c) (1), credit on the basis of amended articles expressly providing that cumulative dividends on its preferred stock should be payable out of surplus or net profits before any dividend on common stock should be paid. *Warren Tel. Co. v. Commissioner*, 128 F. 2d 503, certiorari denied, 317 U. S. 697. Expressly declining to accept the Third Circuit's limited interpretation of the *Northwest Steel* decision, the Sixth Circuit took the position that the language of that opinion necessitated confining the credit of Section 26 (c) to "routine contracts dealing with ordinary debts," the terminology used in that case. Agreements within the body corporate represented in charter and certificate provisions are not, the court said in the *Warren Tel.* case (p. 506), the kind of contract contemplated in Section 26 (c) (1) as

¹ See *Eljer Co. v. Commissioner*, 134 F. 2d 251; *Budd International Corp. v. Commissioner*, 143 F. 2d 784, certiorari denied, 323 U. S. 802; *Philadelphia Record Co. v. Commissioner*, 145 F. 2d 613.

the basis for the limited-credit grant of that Section. Speaking at length of the *Lehigh* decision, the *Warren Tel.* opinion states (p. 506):

This view is not in accord with that of the Third Circuit Court of Appeals in *Lehigh Structural Steel Co. v. Commissioner* [citation omitted]. The court there reasoned that while it was logical to exclude from within the connotation of contract as the term is used in Section 26 (c) (1), a charter or stock certificate which contains no restraint upon the payment of dividends and may be so interpreted only by reading into it state law, it does not follow that a charter or certificate which expressly restrains payment of dividends may not be a written contract within the meaning of the section. In our view, the rationale of the *Northwest Steel Rolling Mills* case is broader than that. The *Lehigh* case overlooks the interpretation that the section refers "to routine contracts dealing with ordinary debts". Having in mind its legislative history and the apparent purpose of the Congress to exempt corporations from the imposition of the tax upon deferred dividends only when the corporation has put it beyond its power to declare them by prior contract obligation to creditors (not stockholders), we hold the present issue to be controlled by the *Northwest Steel Rolling Mills* case.

The First Circuit too, as we have stated, has not been impressed with the narrow reading of the

Northwest Steel opinion given by the Third Circuit in the *Lehigh* case. *Elliott Addressing Mach. Co. v. Commissioner*, 131 F. 2d 700. In the *Elliott* case, the court rejected a claim to credit under Section 26 (c) (1) which was based upon a charter provision requiring the purchase of certain stock before paying dividends to any class except first preferred. The *Warren Tel.* case was approved by the First Circuit, the opinion stating (p. 702)—

From our reading of *Helvering v. Northwest Steel Mills*, [citation omitted], we are of the opinion that the court intended to go farther than the specific facts in that case and that it excluded charter provisions from Section 26 (c) (1).

The court thereupon quoted (p. 702) the language from the *Northwest Steel* opinion to which we have heretofore adverted—that while a corporate charter is for some purposes a contract, it does not follow that Congress intended to include corporate charters in the cautiously limited area for tax credits and deductions under Section 26 (c) (1).⁹

⁹ In the *Elliott* case, the stock to be purchased had been issued to cover a loan to the corporation, and there was some question whether the critical charter covenant had entirely superseded the contract with the creditor which had preceded adoption of the charter provision. As to this facet of the case, the court said (pp. 702-703)—

Even if we were to say that the charter amendment of 1934 did not entirely supersede the original contracts, it cannot be denied that to the extent the char-

The decision of the Circuit Court of Appeals for the Second Circuit in *Monarch Theatres v. Helvering*, 137 F. 2d 588, is not contrary to our position (cf. Br. 18-19). The court there held, *inter alia*, that the resolution of directors with respect to the purchase of certain theatre shares and containing a condition that no dividends be paid until the corporate indebtedness for the purchase price be reduced to a sum stated, was, when taken with the offer, a "written contract executed by the corporation" within the meaning of Section 26 (c) (1). But the resolution in the *Monarch Theatres* case had to do with a creditor obligation; and the court took careful note (p. 590) of the fact that the *Lehigh* case stood alone in holding that a provision in a share certificate and charter made for the protection of a group of shareholders would protect the corporation under Section 26 (c) (1). The court said (p. 590):

* * * we need not hold that the mere fact that the corporate promise is in the form of a resolution, or indeed of a by-law or a charter provision, need make it nugatory. That should depend upon whether the resolution—and perhaps also a by-law

ter amendment fundamentally changes the contracts, reliance must be placed upon it. Under the language of *Helvering v. Northwest Steel Mills*, *supra*, and the * * * cases which we have cited in its support, we find no justification in drawing a distinction between those cases involving merely a charter provision and the case at bar.

or a charter provision—does, or does not, contain a complete contract * * *. If it does not, it will not be within Section 26 (c) (1), even though it may have been intended to be acted upon by creditors, and though creditors have acted in reliance upon it. * * * [Italics supplied.]

Except for the fact that the common stock certificates themselves contained the restriction against dividends, the Court of Claims' decision in *Rex-Hanover Mills Co. v. United States*, 53 F. Supp. 235, is in direct conflict with our position here. That court reasoned in primary part (p. 246) that the May 1, 1936, execution date deadline of Section 26 (c) (1) afforded sufficient protection against the making of restrictive agreements for the purpose of avoiding the surtax, and that Section 26 (c) (1) therefore did not need to be given such construction as would serve to confine its benefits beyond what the court thought to be justified by its words. The court further disapproved (p. 245-246) the reliance of the then Board of Tax Appeals in *Metal Specialty Co. v. Commissioner*, 43 B. T. A. 891, affirmed, 128 F. 2d 259 (C. C. A. 6th), and of the Circuit Court of Appeals for the Sixth Circuit in the case of *Warren Tel., supra*, on the restrictive phrase "routine contracts dealing with ordinary debts" which was used by this Court in the *Northwest Steel* decision; the Court of Claims thought this Court could (p. 246) "hardly have intended to

read into 26 (c) (1) a limitation of the written agreements there mentioned to agreements with creditors, when the Court's language was directed to Section 26 (c) (2)", which dealt only with agreements to discharge "debts". If the execution dead-line were the effective "preventative" which the Court of Claims considered it to be with regard to Section 26 (c) (1), it should have been made to serve without need of further support equally in respect of Section 26 (c) (2) where it likewise appears. We think, further, that the Court of Claims failed sufficiently to consider the fundamental parallelism between the two paragraphs—the difference being, as previously discussed, the grant of a differently computed credit where the obligation was only to retain earnings for the ultimate protection of creditors than where the undertaking was actually to pay or to earmark earnings for the immediate discharge of debts.

It is submitted in any event that the Court of Claims and the Third Circuit erred in holding that Section 26 (c) (1) contemplates restrictions imposed within the corporate framework. The contrary view is fortified by the history of litigation on this point in the Tax Court as well as in the other circuits. The Tax Court has from the statute's inception held, with only such deviation as we have heretofore noted (notes 3, 4, *supra*), that agreements made within the body corporate expressed in charter or stock certificate provisions, are not the type of contract which Congress in-

tended to form a basis for the preference treatment given in Section 26 (c) (1).¹⁰ Furthermore, it has from the outset been the understanding of the Treasury that charter-imposed restrictions do not constitute a qualifying basis for credit under Section 26 (c) (1). See T. D. 4674, XV-2 Cum. Bull. 53 (1936). See also Article 26-2 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, Appendix, *infra*, p. 40.¹¹ As this Court many times has said, the contemporaneous interpretation of a statute by the officials charged with its administration is entitled to great weight and ought not to be disturbed except upon major considerations, especially where the interpretative ruling has been consistent and long-standing. *Overnight Motor Co. v. Missel*, 316 U. S. 572; *Norwegian Nitrogen Co. v. United States*, 288 U. S. 294; *Brewster v. Gage*, 280 U. S. 327; cf. *Miller Hatcheries v. Boyer*, 131 F. 2d 283 (C. C. A. 8th).

¹⁰ The Tax Court continued to maintain this position even after it became evident that it courted continual reversal on the authority of the *Lehigh* case should appeal lodge in the Circuit Court of Appeals for the Third Circuit. *E. g.*, *Eljer Co. v. Commissioner*, decided December 4, 1941 (1941 P-H B. T. A. Memorandum Decisions, Par. 41,533); *Budd International Corp. v. Commissioner*, 45 B. T. A. 737; *Philadelphia Record Co. v. Commissioner*, decided January 23, 1943 (1943 P-H T. C. Memorandum Decisions, Par. 43,038).

¹¹ This article states specifically that—

* * * The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). * * *

It is true that the Bureau of Internal Revenue originally ruled that stock certificates issued before May 1, 1936, which contain an express provision restricting dividend payments, satisfy the requirements of Section 26 (c) (1). I. T. 3109, 1937-2 Cum. Bull. 111; I. T. 3152, 1938-1 Cum. Bull. 155. However, the Bureau promptly revoked its ruling following rendition of the *Northwest Steel* decision,¹² such revocation being undoubtedly inspired by this Court's statement in that opinion (p. 52, fn. 17)—

Respondent contended that the stock certificates satisfied the statutory requisites even if the charter did not; but what we have here said with respect to the charter applies equally to the certificates.

Thus the Bureau also has proceeded since the *Northwest Steel* decision upon an understanding of that case as foreclosing stock certificates along with corporate charters from the grace of the congressional grant found in the statute under consideration.

The clear weight of authority, administrative and judicial, then, is contrary to petitioner's contention. But if this Court intended to reserve the question and was merely speaking discursively when it used the language upon which such extensive reliance has been placed, we feel nevertheless certain that our position is sound as an original proposition. In the statements made by mem-

¹² I. T. 3525, 1941-2 Cum. Bull. 186.

bers of Congress when the 1936 Act was under consideration, there is ample evidence to support our contention that the Legislature intended the credit allowance of Section 26 (c) (1) to be founded on agreements with corporate creditors and not on restrictions imposed within the corporate framework. Thus, Representative Samuel B. Hill, Chairman of the Subcommittee on Taxation of the Committee on Ways and Means, remarked (80 Cong. Rec. 6004):

If a corporation as of March 3, 1936, finds itself in a position, *by reason of a contract entered into with its creditors*, not to pay dividends until it has paid its creditor his debt or has established a sinking fund, or otherwise provided means of paying the obligation, if it is under that handicap by reason of a written contract, then we allow the corporation a 22½ percent flat rate on that portion of the net income which it is unable to pay out, by reason of this contract, in dividends. [Italics supplied.]

Another member of the subcommittee, Representative Fred Vinson, stated (80 Cong. Rec. 6212):

Moneys are obtained upon expressed promises that dividends will not be declared until the loan and interest is repaid in whole or in part. The committee recognizes the position in which the taxpayer is placed. * * *

Obviously the reason thus expressed for exemption from tax does not obtain where the restric-

tions are internally imposed. Nor, where such is the case, is the corporation ordinarily "placed in a position" from which it cannot extricate itself as is the case where the contract is creditor-imposed. To be sure, preferred stockholders may be reluctant to relinquish their special rights. But in the ultimate, their interest is that of a proprietor in the business, and concern for its fortunes may prompt concessions which a creditor who is to be paid his principal and interest at all events, would not make. If it appears that a heavy tax burden will hamper the corporation's operations, it is reasonable to assume that those shareholders will not stand on rights which are obstacles to alleviation of the hampering condition. A creditor, not thus motivated, can afford to and usually would be adamant. This last, we believe, is the "position in which the taxpayer is placed" which the committee "recognized" when it afforded the exemption.

It is significant too that Congress should have used precisely the same words in both paragraphs of the Section to describe the contract—"a written contract executed by the corporation." Congress certainly expected paragraph 1 of the Section to be read in context. See *Commissioner v. Bristol*, 121 F. 2d 129 (C. C. A. 1st). And there could be no rational purpose in confining to the discharge of creditor obligations the paragraph dealing with actual payment or earmarking if it were not intended similarly to circumscribe the para-

graph dealing with mere arrangements for payment *in futuro* by way of retention of corporate earnings. The petitioner could have claimed no credit under Section 26 (c) (2) had it actually redeemed its preferred stock during the taxable year, for a corporation is not "indebted" to its shareholders. *Warren v. King*, 108 U. S. 389. There would therefore seem no sound ground for it now receiving preferential treatment under Section 26 (c) (4) by reason, in effect, of postponing redemption. We think it must be assumed that Congress advisedly used the same words in both paragraphs to describe the same kind of contract.¹³

II

THE CHARTER WAS NOT A CONTRACT "EXECUTED" BY THE TRANSFEROR CORPORATION NOR DID ITS STOCK CERTIFICATES "EXPRESSLY" DEAL WITH THE PAYMENT OF DIVIDENDS

The decision below is plainly entitled to affirmation if we are correct in maintaining that Section

¹³ It should be noted that the Third Circuit held that a stock certificate provision similar to that in the instant charter does not actually prohibit the payment of dividends but is merely an intracorporate agreement as to priorities in their payment. *Budd International Corp. v. Commissioner*, 143 F. 2d 784, 793, certiorari denied, 323 U. S. 802. However, under the statute, there must be a contract which actually operates as a legal compulsion to retain earnings. See *Welsbach Eng. & Management Corp. v. Commissioner*, 140 F. 2d 584 (C. C. A. 3d), certiorari denied, 322 U. S. 751; *Martin Realty & Min. Co. v. Commissioner*, 130 F. 2d 1003 (C. C. A. 8th); *Helvering v. Magnus Beck Brewing Co.*, 132 F. 2d 379 (C. C. A. 2d); *Clover Splint Coal Co. v. Commissioner*, 130 F. 2d 52 (C. C. A. 3d); *Buffalo Slag Co. v. Commissioner*, 131 F. 2d 625 (C. C. A. 2d).

26 (c) (1), credit is limited to agreements made with creditors of the claimant corporation. There are in our judgment other reasons, however, why the petitioner does not qualify under the statute:

(a) Section 26 (c) (1) provides specifically that the contract upon which reliance is placed shall be "executed" by the corporation. The petitioner relies in part upon its transferor's stock certificates but necessarily it must depend in the ultimate upon the charter, since there is a provision dealing with dividends in the certificates only if the pertinent charter term be read into them, and since it is the charter rather than the certificates which create the stockholders' rights. Accordingly, we think, any inadequacy under Section 26 (c) (1) inhering in the charter must of necessity adhere to the certificates,¹⁴ and we submit that a further inadequacy of the charter beyond that previously discussed is that it was not a contract "executed" by the corporation within the meaning of the statute.

The ordinary meaning of the word "executed", when used with reference to a written instrument, is "signed" or "signed, sealed and delivered". I Bouvier's Law Dictionary (Rawles' Third Revision) 1111; 15 Words and Phrases, 551-553 (Perm. ed.). And, since there is no indication that Congress intended the word "execution" to

¹⁴ Cf. *Elliott Addressing Mach. Co. v. Commissioner*, 131 F. 2d 700 (C. C. A. 1st); *Caroline Mills v. Commissioner*, 126 F. 2d 857 (C. C. A. 5th).

have here a particular or different meaning, it seems clear that Section 26 (c) (1) applies only to a written contract which the corporation has signed in ordinary course. Corporate charters are secured through the filing of articles of incorporation by individuals desiring to incorporate and by the issuance of a certificate of incorporation by the state. The corporation itself has no existence until the certificate is issued, and it obviously does not execute the articles of incorporation.¹⁵ Nor does the situation differ fundamentally where, as here, we are concerned as well with amended articles. True; the corporation is in existence while its amended articles are pending acceptance by the state, and it is the corporate officers or directors who sign the application to amend on the corporate behalf. But it seems to us that if Congress did not intend the original

¹⁵ The requirement that the contract must be "executed by the corporation" has a bearing also upon the argument made in part I of this brief—that the statute contemplates contracts with creditors, not intra-corporate restrictions. It is the corporate charter, an instrument not executed by the corporation, which creates and defines the rights and priorities of the several classes of shareholders *inter se*. The issuance of stock certificates merely furnishes additional evidence of the existence of rights which lodge in the charter. If no certificates were issued reiterating the charter provisions, the stockholders' rights would be no less; and they are no greater by being so repeated. Congress was not thinking, we submit, of charter provisions defining the rights of shareholders, or of stock certificates repeating those provisions, when it required in Section 26 (c) (1) that the provision restricting dividends must be contained in a contract "executed by the corporation".

charter to be considered a contract "executed" by the corporation, there could be little reason in accepting as a basis for credit amended articles merely by reason of their being amended. The process of amendment is no different fundamentally than the process of initiation, or certainly it should not be so regarded for the purpose of the federal revenue laws.

This Court said in the *Northwest Steel* case (311 U. S. 46, 49):

The natural impression conveyed by the words "written contract executed by the corporation" is that an explicit understanding has been reached, reduced to writing, signed and delivered.

Quite obviously, these words do not describe the act of a corporation in filing articles either of incorporation or of amendment; that act is in the nature of a supplication to the state. In *Atlas Supply Co. v. Commissioner*, 123 F. 2d 356 (C. C. A. 10th), the court refused credit under Section 26 (c) (1) where the "contract" relied on was a provision of the by-laws prohibiting dividend distributions which would impair capital. The by-law was not, the court said (p. 357), a contract formally executed by the corporation such as the statute plainly requires.¹⁸ The same conclusion was reached by the Circuit Court of Appeals for the Fifth Circuit in respect of a stockholders'

¹⁸ See also *Commissioner v. Columbia River P. M.*, 127 F. 558 (C. C. A. 9th).

resolution reciting an oral agreement between bondholders' and stockholders' committees wherein the stockholders agreed not to pay out dividends until past due bond interest had been met, the resolution being subsequently approved by the corporation's board of directors. *Caroline Mills v. Commissioner*, 126 F. 2d 857. The court there adopted the Commissioner's position that the resolution was not in the form of a contract and was not properly executed as a contract by the corporate officers.

In *Mastin Realty & Min. Co. v. Commissioner*, 130 F. 2d 1003 (C. C. A. 8th), a creditor offered to make loans to the corporation if it would pay no dividends until he was reimbursed. The corporation accepted the money and thereafter spread upon the minutes a resolution signed by its directors to the effect that all money borrowed should be paid in full before distribution of any dividends. The court held that the resolution did not satisfy the statute, *inter alia* because it was not on its face a formal contract but only a declaration of corporate policy. The court remarked (p. 1005), that the resolution was not signed by the corporation or by any of its officers and hence was not "executed"; the minutes were signed, but they gave no indication of being intended as anything more than a record of what transpired at the directors' meeting. The court said (p. 1006):

We need not consider whether * * *
[the creditor] could hold the corporation

to a contract as evidenced by his letter and the resolution and acts under them because more than that is required here. A written contract specifically dealing with the payment of dividends must have been executed by the corporation.

Here, too, it is immaterial whether the transferor corporation's charter represented an enforceable agreement, because more than that is required under Section 26 (c) (1). A written contract dealing with the payment of dividends must have been "executed" by the corporation, and the charter upon which the petitioner must in final analysis rest its case does not fulfill that requirement.

(b) Section 26 (c), (1) also provides specifically that the contract relied upon must "expressly" deal with the payment of dividends. Even if we should consider that the stock certificates here were contracts of the class intended, and that they were contracts "executed" by the corporation when read together with the "unexecuted" charter—as necessarily they must be—they still would not answer the statutory conditions because the very necessity of referring to the charter in order to find any prohibition upon dividends prevents considering the certificates as contracts "expressly" dealing with the payment of dividends. In the *Northwest Steel* case, where

in rejecting the contention that claim to credit could rest upon an implied-in-law term of restriction, this Court said (p. 49):

True, obligations not set out at length in a written contract may be incorporated by specific reference, or even by implication. But Congress indicated that any exempted prohibition against dividend payments must be expressly written in the executed contract. It did this, by adding a precautionary clause that the granted credit can only result from a provision which "expressly deals with the payment of dividends".

This language is clear indication, we think, that the Court did not believe that such common-law concepts as the doctrine of incorporation by reference were available to a claimant "in the cautiously limited area permissible for tax credits" (311 U. S. at p. 51) under this Section.¹⁷

¹⁷ Such cases as *Glenn v. Chess & Wymond*, 132 F. 2d 621 (C. C. A. 6th); *Automotive Parts Co. v. Commissioner*, 134 F. 2d 420 (C. C. A. 6th), and *Monarch Theatres v. Helvering*, 137 F. 2d 588 (C. C. A. 2d) are perhaps authority pointing *contra*. In those cases incorporation by specific reference was not involved, but the credit was allowed on restrictive agreements spelled out by reading several instruments together. Those cases were chiefly concerned, however, with whether or not there was a complete contract and not with whether the prohibition against dividends in the instrument relied upon was "express". And cf. *Budd Wheel Co. v. Commissioner*, 45 B. T. A. 963.

CONCLUSION

For the foregoing reasons, the decision of the court below should be affirmed.

Respectfully submitted.

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APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term “adjusted net income” means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(2) The term “undistributed net income” means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c): \

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

17 per centum of the portion of the undistributed net income which is in excess of

20 per centum and not in excess of 40 per centum of the adjusted net income.

22 per centum of the portion of the undistributed net income which is in excess of 40 per centum and not in excess of 60 per centum of the adjusted net income.

27 per centum of the portion of the undistributed net income which is in excess of 60 per centum of the adjusted net income.

(c) *Adjusted Net Income Less Than \$50,000.*—

(1) *Specific credit.*—If the adjusted net income is less than \$50,000, there shall be allowed a specific credit equal to the portion of the undistributed net income which is in excess of 10 per centum of the adjusted net income and not in excess of \$5,000, such credit to be applied as provided in paragraph (2).

(2) *Application of specific credit.*—If the corporation is entitled to a specific credit, the tax shall be equal to the sum of the following:

(A) A tax computed under subsection (b) upon the amount of the undistributed net income reduced by the amount of the specific credit, plus

(B) 7 per centum of the amount of the specific credit.

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(c) *Contracts Restricting Payment of Dividends.*—

(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate

of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

(2) *Disposition of profits of taxable year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

Treasury Regulations '94, promulgated under the Revenue Act of 1936:

ART. 26-2. *Credit in connection with contracts restricting payment of dividends.*—

(a) The credit provided in section 26 (c)

with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1); in that they prohibit or limit the payment of dividends during the taxable year; and

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings or profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936.

If a corporation is restricted with respect to the payment of dividends by two or more contract provisions coming within section 26 (c) (1), only the largest of the credits computed with respect to each of such provisions, and not their sum, shall be allowable under section 26 (c) (1) and, for such purpose, if two or more credits are equal in amount, only one shall be taken into account. However, section 26 (c) (3) provides that if both section 26 (c) (1) and section 26 (c) (2) apply, only the one of such paragraphs which allows the greater credit shall be applied, and, if the credit allowable under each paragraph is the same,

only one of such paragraphs shall be applied.

(c) *Disposition of profits of taxable year.*—Under the provisions of section 26 (c) (2), a corporation is allowed a credit in an amount equal to that portion of the earnings and profits of the taxable year which, by the terms of a written contract executed by the corporation prior to May 1, 1936, and expressly dealing with the disposition of the earnings and profits of the taxable year, it is required within the taxable year to pay in, or irrevocably to set aside for, the discharge of a debt incurred on or before April 30, 1936. The credit is limited to that amount which is actually so paid or irrevocably set aside during the taxable year pursuant to the requirements of such a contract.

Only a contractual provision which expressly deals with the disposition of the earnings and profits of the taxable year shall be recognized as a basis for the credit provided in section 26 (c) (2). A corporation having outstanding bonds is not entitled to a credit under a provision merely requiring it, for example, (1) to retire annually a certain percentage or amount of such bonds, (2) to maintain a sinking fund sufficient to retire all or a certain percentage of such bonds by maturity, (3) to pay into a sinking fund for the retirement of such bonds a specified amount per thousand feet of timber cut or per ton of coal mined, or (4) to pay into a sinking fund for the retirement of such bonds an amount equal to a certain percentage of gross sales or gross income. Such provisions do not expressly

deal with the disposition of earnings and profits of the taxable year. A contractual provision, however, shall not be considered as not expressly dealing with the disposition of earnings and profits of the taxable year merely because it deals with such earnings and profits in terms of "net income," "net earnings," or "net profits."

The term "debt" as used in section 26 (c) (2) does not include an obligation of the corporation to a shareholder, as such, as distinguished from a creditor. Accordingly, amounts paid into, or set aside for, a sinking fund by a corporation for the retirement of preferred stock, pursuant to the terms of an agreement underlying the preferred stock issue, shall not be considered as set aside for discharge of a debt. An indebtedness evidenced by bonds or other similar obligations issued by a corporation is incurred as of the date such obligations are issued, and the amount of such indebtedness is the amount represented by the face value of the obligations. For the purpose of this article a bond or other similar obligation is not issued until it is executed and delivered to a person who holds it as a debt of the corporation. Bonds issued after April 30, 1936, in exchange in refunding a preexisting issue represent debts incurred after April 30, 1936, within the meaning of section 26 (c) (2).

